1-1-2003

# Motivating Retirement Planning: Problems and Solutions

Gary W. Selnow
*San Francisco State University*

## Motivating Retirement Planning: Problems and Solutions

### Abstract

People often find it difficult to make the right decision about retirement savings. The payoffs are in the distant future, and the promise of pleasure tomorrow can mean pain today. The wrong decision yields an instant gain, the outcome is uncertain, the decision can be postponed without immediate penalty. In the end, the pressures of immediate gratification, delayed benefit, the unknown, the uncertain, the uncomfortable, ally against wise decisions. Yet, while many people yield to these influences, many others make the right choice. That drives us to ask why. Recent research has examined various approaches to promoting retirement investment. One promising strategy, automatic enrollment, taps into an old theory about the functional order of behavior and attitudes. This chapter examines the theory to understand why automatic enrollment has a good chance of overcoming the natural impediments to wise decisions about retirement investments.

### Disciplines

Economics

### Comments

The published version of this Working Paper may be found in the 2004 publication: *Pension Design and Structure: New Lessons from Behavioral Finance*.

# Pension Design and Structure

## New Lessons from Behavioral Finance

EDITED BY

Olivia S. Mitchell and
Stephen P. Utkus

OXFORD
UNIVERSITY PRESS

OXFORD
UNIVERSITY PRESS

Great Clarendon Street, Oxford OX2 6DP

Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
and education by publishing worldwide in

Oxford New York

Auckland Bangkok Buenos Aires Cape Town Chennai
Dar es Salaam Delhi Hong Kong Istanbul Karachi Kolkata
Kuala Lumpur Madrid Melbourne Mexico City Mumbai Nairobi
São Paulo Shanghai Taipei Tokyo Toronto

Oxford is a registered trade mark of Oxford University Press
in the UK and in certain other countries

Published in the United States
by Oxford University Press Inc., New York



British Library Cataloguing in Publication Data
Data available

Library of Congress Cataloging in Publication Data
Data available

ISBN 0-19-927339-1

Typeset by Newgen Imaging Systems (P) Ltd., Chennai, India
Printed in Great Britain
on acid-free paper by
Biddles Ltd., King's Lynn, Norfolk

Chapter 2

# Motivating Retirement Planning: Problems and Solutions

*Gary W. Selnow*

Retirement saving advocates face one of the most daunting communication tasks imaginable. They seek to promote within the labor force a willingness to set aside scarce resources for some distant age that the worker may or may not reach, for rewards that the worker may or not achieve, at a price today that the worker may not wish to pay. This is a tough sell, however, recent research and an old theory lend some guidance and encouragement. This chapter looks at the nature of the challenge and the rationale for some interesting solutions.

To motivate our discussion, though, I offer a story from the Balkans which helps illuminate how some people view their financial circumstances to be driven by fate. It takes place on a river that forms the border between Slovenia, part of the former Yugoslavia, and Austria, part of the West. People tell of a Slovenian fisherman who had been laboring for hours but had not caught a fish; the poor fellow had felt not even the tug of a fish on his line. Meanwhile, on the other side of the river in Austria, a young boy was reeling in fish by the bucketful. He would toss out his line, and before it struck the water's surface, a fish would leap up and grab the hook in mid-air. Eventually, the fisherman could bear it no longer and looked about for a way to cross the river. Since he could find no boats or bridges, the Slovenian man shouted at the boy, "Hey, how did you cross the river?" The boy stared back for a moment, and then yelled back, "I was born here!"

In short, fate—in our case, financial fate—is often determined from birth. Depending on which side of the river you are born on, you can live a charmed life or a life of toil and frustration. The hard truth is, some people need not bother with plans for retirement: This problem is settled for them at birth. Most people, however, find themselves on the wrong shore and accept this as their fate. That being so, one job for retirement savings planners is to show people how they can get to the other side of the river, where the retirement fishing is good.

Investing for retirement is different from just about anything else people are asked to do. Along nearly every dimension, tucking away money today for a more secure tomorrow violates basic human inclinations. The savings ethic is resistant to nearly all of the motivators we commonly use to encourage desired behaviors, which robs retirement planning advocates of the most useful and effective tools to stimulate wise investment decisions.

In thinking about these problems, I reflect on the challenges I have faced over the years in recent years, persuading people to alter their behaviors. Most recently, we set out to tackle the HIV/AIDS tragedy in Africa, and our communication work has had some real success. Nevertheless, tackling the AIDS problem, as overwhelming as that is, is quite different from the challenges communicators face getting people to save for retirement. In the regions where I work, people see the evidence of AIDS all around them. Each morning they arise to the palpable devastation wrought by the plague, each night they fall asleep haunted by their private fears that it will infect them as well. Stories from communities being slaughtered by AIDS chill the soul. Our message of caution and hope is well received because the audience is ready. Moreover, opinion leaders figure prominently in our design as we work closely with traditional healers and birth attendants who are revered within the communities. Our job is to establish credibility, connect the behaviors with the outcomes, and teach about alternatives.

By contrast, retirement issues have less conspicuous consequences, and they lack the stunning horrors that reign in AIDS-infected communities. Moreover, in the AIDS work, the lapse time between behavior and consequence is much shorter, and the outcomes are more certain. These conditions enable us to use persuasive methods not available to advocates of retirement savings, because as important as retirement preparations may be, their structure deprives advocates of many tools.

Another of our recent assignment involves the development of attitudes favorable toward reconciliation, in places where reconciliation is a four-letter word. We work throughout the Balkans—in Croatia, Bosnia, Montenegro, Kosovo, and now Serbia—to encourage people of different ethnicities to live together in peace. We have seen some evidence of steps in the right direction where isolated communities that once quite literally battled over backyard fences, have begun to patch up old wounds. This is taking place with the efforts of many indigenous and international organizations, but I would like to think that we have made a contribution. In places that exaggerate the differences between people, we emphasize the features that people share. We join parents through their children at multiethnic schools, and more recently we have connected people through medical programs. Illness does not discriminate: Heart disease, asthma, cancer, and HIV/AIDS, cut a cruel swath across the human race. Our programs remind people that everyone shares these assaults, and there are bigger enemies that stand over us all. Attitudes and behaviors here, too, are structurally different from the attitudes and behaviors retirement planners seek to change. Where I work, people have lived through the consequences of corrosive thinking and destructive actions. They know that a bad decision or a good one can manifest itself immediately to their benefit or to their ruin. And again, retirement issues are unlike these issues and they do not allow supporters to tap the human motivators that we can access in our work. Problems faced by retirement savings advocates are quite different and quite frustrating.

It is also worth noting that techniques which increase voting, garner political support, improve diet and exercise, get people to brush their teeth, paint their houses, and vaccinate their children, are fundamentally different from getting people to save for retirement. No matter how I size it up, the conclusion is the same retirement savings issues are unique in several ways:

*First, the payoff for behavioral change is quite uncertain.* Saving for retirement is a gamble, and the truth is, no one can promise that money set aside will ever come back to us. We may die, financial markets may crash, and events on this troubled and treacherous planet can change our fates.

*Second, workers do not easily buy the idea of payoffs in the distant future.* For a here-and-now, instant-gratification society, this is troubling. Ben Franklin advised us that if we wanted to be wealthy, we should "think of saving as well as getting." For many people today, Ben's advice falls on deaf ears.

*Third, the promise of pleasure tomorrow means pain today.* This is a hard sell. Setting aside even a few dollars each month is most painful when the need for cash is greatest—when one is raising children, buying a home, paying for education. A pleasant and secure retirement is a daydream, when the mortgage comes due and the kids need braces.

*Fourth, the wrong decision yields instant gain.* This is the flip side: When the worker chooses *not* to save that $100, he is immediately rewarded with $100 that he can enjoy in the here-and-now. Instant gratification is very familiar.

*Fifth, there is no immediate tangible reward.* One's sacrifices, good judgments, loyalties to one's future-self, yield little today of the self than a vague satisfaction. Citizens of the material world are motivated by fast automobiles, handsome clothes, good food, and drink: These are the rewards and symbols of success. Money planted deep for retirement bears none of those harvests, and it returns only a promise bound to a probability. The contingent–reward link is broken, which undermines a powerful behavioral motivator.

*Sixth, the saving decision can be postponed without immediate penalty.* Workers suffer little today if they fail to save for tomorrow; they deprive themselves of nothing, now, and they walk away from this unfulfilled duty unaltered and unharmed.

*And finally, there are no functional deadlines.* People believe they do not have to save today and do not have to save tomorrow. The immediate rewards for deciding to save grow no greater and the punishments for declining to save become no more severe. It is not like failing to pay the mortgage, or the water bill, since letting those deadlines go, makes quick trouble. With retirement savings, there is always tomorrow and the day after tomorrow.

As a result, the pressures of immediate gratification, delayed benefit, the unknown, the uncertain, the uncomfortable, the deferrable, all ally against the wiser choices. And they also strip retirement planning advocates of powerful human motivators and inducements. Furthermore, the details of retirement savings are complicated for average people. The laws and rules are esoteric and ever-changing. Too many options confuse people: SEP plans, 401ks, 402ks, IRAs, 403bs and the rest, form in the public mind, a confusing stew of options that for many people are easier left for another time, another place.

On top of all this, most young people are firmly convinced they will always be young; belief in one's immortality is a mighty force. And, peer pressure is scarce: Discussions about financial preparations for retirement do not arise spontaneously around the water cooler, and friends do not pressure one another about retirement set-asides.

Finally, Social Security is an easy palliative. Although ill-fated, underfunded, and precariously unprotected, Social Security is, in many people's minds, that secret place for comfort when thoughts tread near retirement savings. Consequently, judgments become clouded by complexities, legalities, choices, norms, and expectations. Sometimes it seems a wonder anyone bothers to save for retirement at all. Yet, many people do save and the question is what motivates them to do so? The literature suggests a variety of reasons, programs, and conditions that lead to or are associated with retirement savings decisions. For one, older people save more than younger people (Hogarth, 1991; Zhong, 1994); more educated people save more than less educated people; employees with higher incomes put aside more than employees with lower incomes (Zhong, 1994). We would be surprised to learn otherwise. These facts are good to know, but not prescriptive. Retirement advocates cannot do much here, other than urge people to attend college then wait for them to age and earn more money.

The literature says, further, that people with a future orientation save more than people who live for the here and now (Munnell, Sundén, and Taylor, 2000). A popular analyst proposes that people who are content with what they have—and thus seek fewer possessions—are those more likely to save for the years beyond (Richey, 2002). But how this can be of use to motivate people who live for today, or those who are not content with what they have? Maybe advisers could promote favorable attitude formation by dislodging cultural preoccupations with the present, but this would acquire house-to-house combat in a society where a focus on the present is woven into the fabric of every popular message, of every public and private institution. Consider that Congress looks no further than the next election, companies plan quarter-by-quarter, and public policy fixes on immediate impact.

What about other motivators? For example, education can build knowledge that can inspire a rational person to action. To be sure, education about saving is a consistent theme in the literature: People aware of the need to save and familiar with investment options are more likely to set aside money for later. The cause and effect relationships are not entirely clear in many studies: Does education bring about investment decisions, or do investment decisions stimulate an interest in learning about saving? Either way, many analysts believe that education is the key.[1] Joo and Grable (2000) argue that workplace financial education boosts the likelihood of having a retirement investment or savings program. They argue, further, that family and consumer economists can help individuals plan for retirement with additional financial education. Hershey and Mowen (2000) find that training programs designed to boost financial knowledge trigger advanced planning activities, and they also demonstrate the value of audience segmentation based on attitudinal characteristics.

Whether education relates favorably to retirement planning behaviors because it cultivates skills, nurtures attitudes, or simply responds to predispositions, is less important than the finding of education's relevance. This is a comfort, because the last thing I want to suggest is that we have been barking up the wrong tree. But I do suggest that, so far, our educational approach has been vulnerable to the natural resistance people display toward investing in their distant futures. Yes, education impacts many employees, but the alarming fact remains that 70 percent of American workers have not even calculated their financial needs for retirement, half have made negligible contributions to their retirement funds, and fully 15 percent have saved nothing for their later years (EBRI, 2002). So large numbers of employees remain untouched by the best efforts of educators who would teach them about the virtues of salting away funds for later.

Is there a way around the natural defenses against retirement savings? Is there a way to defeat the resistance, the reluctance, the refusal of employees who balk at the advice to save? Is there a better way to cross the river? Maybe the answer is yes. Several researchers have been looking at the value of automatically enrolling employees in retirement investment programs. I believe this automatic enrollment approach may be the way to end-run the natural blocks evident in the persuasion-resistant activity. They also tap into a theory that I believe has great relevance to this discussion.

To elaborate on this point, I make reference to the work of Choi et al. (2001*a*), who reported that "automatic enrollment has a dramatic impact on retirement savings behavior: 401(k) participation rates at all three firms (they studied) exceed 85 percent." The researchers found that participants usually anchored at the lowest saving default rates, and in the most conservative vehicles, but this does not detract from the fact that enrollment led to dramatic participation. Why does automatic enrollment have the impact they reported? Choi and his co-authors also find that employees follow the "path of least resistance" (Choi et al., 2001*b*). In other words, it is easier to keep on doing what you are doing, than it is to change. So for sailing ships and employees alike, steering straight ahead is easier than changing course. Once the employee is enrolled, they stay enrolled; if they are not enrolled, they remain not enrolled. The lesson is clear: Enroll employees automatically and plan sponsors will have set them on the proper course for the other side of the river.

This interesting research brought to mind a book by psychologist Daryl Bem, who in his book, *Beliefs, Attitudes, and Human Affairs* (1970), discusses a theory whose arrangement of variables violates convention. Most of us subscribe to the notion that people first acquire knowledge, from knowledge we form attitudes, and from the attitudes flow our consequent behaviors. Knowledge shapes attitudes, and then behavior. But Bem argues that sometimes behavior comes first. Sometimes we find ourselves behaving in a certain way, and we infer from that behavior our attitudes. In Bem's words, "(it is a) common assumption that one cannot change the behavior of (people) until one has changed 'hearts and minds' first . . . in fact, one of the most effective ways of changing the 'hearts and minds' of (people) is to change their behavior first" (Bem, 1970: 3). His examples include racial integration during the early 1950s and 1960s, citing instances where people with the strongest positive attitudes toward integration were those who were positioned to experience integration first-hand. Further, other research on integration demonstrated that "the cause-effect sequence most often appears to be 'behavior first, then attitudes' " (Bem, 1970: 68).

A good example of this point occurred when President Truman banned segregation in the armed forces with a stroke of the pen in 1948. The very fact of suspicious whites having to live and work and serve with blacks paid off in the striking improvement of attitudes. Of course, attitudes about race changed for blacks as well as for whites. Military people, by virtue of the government's power to impose behavior on the troops, had for years been well ahead of civilians on attitudes toward racial matters.

Another example of knowledge first, then attitudes, occurred in California during the 1990s. Over a period of time, California tightened regulations on cigarette smoking, first restricting smoking in public buildings and, then in workplaces and in restaurants; then curtailing smoking outside near the doors of public buildings, workplaces, and restaurants; and most recently, in 1998, the State banned smoking in bars, the last citadels for smokers (California Department of Health Services, 2001). Currently, Californians are allowed to smoke only in caves with fewer than two occupants and in aluminum kayaks anchored beyond the 3-mile limit!

What has been the result? The California Department of Health Services reports the following: "During the 1990s in California, smoking *behaviors* and *attitudes* about smoking have changed, as measured by the California Tobacco Surveys and other data sources (emphasis added). The net effect has been not only a drop in smoking rates at twice the national average, but a corresponding change in public attitudes toward smoking as well. Were attitudes changing anyway? Perhaps, but the behavioral changes imposed by the regulations are likely responsible for the accelerated shifts in the way people have come to view smoking."

Even if behavior changes first and then attitudes, how does this work? Bem emphasizes two dynamics. First, cognitive dissonance is key. This is the uncomfortable sense that develops when we act in a way that is incongruous with our beliefs. Second, self-perception theory suggests inasmuch as we infer the attitudes of others by observing their behaviors, we often infer our own attitudes by observing our own behaviors. We behave according to situational demands and then infer from that what our beliefs must be. We do this because we dislike the discomfort of incongruity between behaviors and beliefs, and because we believe we are rational and logical and hence interpret our self-conceptions by way of what we see in our own behavior.

One condition must be in place: We must see ourselves as having an escape, and having at least some choice in the behavior. Why? Because if we believe we are coerced, the force of coercion becomes the obvious explanation for our behaviors rather than our supporting beliefs. So, people seem logical and consistent—or at least they like to believe this about themselves—and accordingly, their behaviors cue our attitudes as long as they have at least some choice in the matter.

What does behavior-first have to do with automatic enrollment? What does it have to do with getting people to the other side of the river? The studies show that automatic enrollment with an easy escape offers the initial behavior. People may stay the course of least resistance, but effort alone may not explain the fact that nine of ten employees stay with an automatic retirement savings program after 6 months, and after 36 months the enrollment numbers remain about a third higher than for employees not under automatic enrollment plans. In other words, people who examine their savings behavior may infer that their own values and beliefs actually support the merits of retirement savings. Automatic enrollment imposed the initial behavior. The path of least resistance may help employees stay the course, and the fact that they were enrolled and could unenroll at any time of their choosing—but did *not* unenroll—may actually lead to altered beliefs about savings.

One further point bears mention. If attitudes do, in fact, change in light of behavior, then we might anticipate reasonable success with automatic upgrading of enrollment programs as well. Research finds that "employees do succeed in raising their contribution rates if they are given a low-effort opportunity to sign up for an automatic schedule of increases in their contribution rate" (Choi et al., 2001*b*). Why is this so? It must be more than "stay the course," because even the low-effort opportunity requires some action that we would not reasonably expect, unless supporting attitudes were in place. Employees who have come to look favorably at the concept of retirement saving and accept the practice at the entry level are more likely to accept incremental increases. The hard work has been done; the basic belief has been forged. Automatic enrollment, coupled with automatic upgrades proposed the "Save More Tomorrow" plan advocated by Benartzi and Thaler (2004), fit reasonably well into the "behavior-first" model of attitude formation.[2]

An automatic enrollment approach has a real chance of success because it skirts the natural impediments to employee-initiated investment plans noted earlier. The delay and uncertainty of payoffs, the deferral of rewards, the imposition of sacrifices and other pains and suffering of initiating a retirement savings plan become less relevant. The behavior-first model begins with automatic enrollment, but it must not end there. Employee education will continue to play a significant role. The huge advantage of behavior-first is that it puts in place the mechanisms of attitude change that could not only make employees more supportive of savings behaviors, but can also heighten their interests in educational messages. Automatic enrollment programs should, therefore, include employee educational elements that prepare people for their active involvement in the ongoing maintenance and fine-tuning of their retirement savings plans. Approaches to employee education laid out by many advocacy groups are not only valid, but they are essential to the long-term success of the plan. With education, we complete the cycle: Behavior, attitudes, and knowledge, knowledge, attitudes, and behavior—each element supporting the other in maintaining the employees' involvement in retirement savings.

Fortified by ongoing employee education, automatic enrollment has genuine appeal because it begins where other approaches hope to end, and it appears promising because it sets in motion dynamics often overlooked. The nice thing about the behavior-first approaches is that they come at little cost, they preserve employee discretion, and they do not replace the need for ongoing education and similar interventions that arm employees with tools for greater control of their own financial futures. This is a promising and fruitful means of helping people to the other side of the river.

## Notes

[1] See, for instance, Richardson (1993), Taylor-Carter, Cook, and Weinberg (1997), Bernheim, Garrett, and Maki (1997) and many others.

[2] Benartzi and Thaler (2004), discuss a "Save More Tomorrow" plan where employees agree in advance to earmark a portion of their future pay increases for retirement savings. Promise today to pay more tomorrow, but this time, put it in writing. They report considerable success noting that 78% who were offered the plan chose to use it; almost everyone who joined remained in it through two pay raises, and four out of five stayed with it into the third pay raise; and the average saving rates increased from 3.5% to 11.6% in 28 months.

## References

Bem, Daryl J. 1970. *Beliefs, Attitudes and Human Affairs*. Belmont, CA: Wadsworth.

Benartzi, Shlomo, and Richard H. Thaler. 2004. "Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving." *Journal of Political Economy* 112(1): February 164–187.

Bernheim, Douglas B., Daniel M. Garrett, and Dean M. Maki. 1997. "Education and Saving: The Long-term Effects of High School Financial Curriculum Mandates." National Bureau of Economic Research Working Paper No 6085.

California Department of Health Services. 2001. "California Tobacco Control Program: A Decade of Progress: Results from the California Tobacco Survey, 1990–1999." Prepared by the Cancer Prevention and Control Program, University of California, San Diego, December 26.

Choi, James J., David Laibson, Brigitte Madrian, and Andrew Metrick. 2001*a*. "For Better or For Worse: Default Effects and 401(k) Savings Behavior." Pension Research Council Working Paper 2002–2.

—— 2001*b*. "Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance." Pension Research Council Working Paper 2002–3.

The Employee Benefit Research Institute (EBRI). 2002. The American Savings Education Council (ASEC), and Mathew Greenwald and Associates (MGA). Retirement Confidence Survey www.asec.org/media/pr143.htm.

Hershey, Douglas A. and John C. Mowen. 2000. "Psychological Determinants of Financial Preparedness for Retirement." *The Gerontologist* 40(6): 687–697.

Hogarth, J. M. 1991. "Asset Management and Retired Households: Savers, Dissavers and Alternators." *Financial Counseling and Planning* 2: 97–122.

Joo, So-hyun and John Grable. 2000. "A Retirement Investment and Savings Decision Model: Influencing Factors and Outcomes." *Consumer Interests Annual* 46: 1–7.

Munnell, Alicia H., Annika Sundén and Catherine Taylor. 2000. "What Determines 401(k) Participation and Contributions?" Center for Retirement Research at Boston College CRR WP 2000–12, December.

Richardson, Virginia E. 1993. *Retirement Counseling: A Handbook for Gerontology Practitioners*. New York: Springer.

Ritchey, Matt. 2002. "Your Most Important Financial Decision". From the "Motley Fool Website" www.fool.com/news/foth/2002/foth020322.htm.

Taylor-Carter, Mary Anne, K. Cook, and C. Weinberg. 1997. "Factors Influencing Attitude Toward Retirement and Retirement Planning Among Mid-life University Employees." *Journal of Applied Gerontology* 13: 143–156.

Zhong, Lucy X. 1994. "Factors Associated with Bond and Stock Holdings." *Consumer Interests Annual* 40: 359–360.